No. 385

IN THE

United States Court of Appeals

For the Second Circuit.

THEODORE C. BONNEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPENDIX TO PETITIONER'S BRIEF.

VICTOR G. MOUNT,
Attorney for Petitioner,
103 Fall Street,
Seneca Falls, N. Y.

JOHN J. NICIT,
Of Counsel,
Waterloo, N. Y.

2ND CIRCUIT

THE REPORTER COMPANY, INC., Walton, N. Y.—1956

Index to Appendix.

	Page
Statement	1a
Decision	2a
Opinion and Findings	3a
Order	52a
Transcript	53a
Albert Towers:	
Direct	53a
Albert Averbach:	
Direct	59a
Theodore Bonney:	
Direct	60a
Cross	65a
Stipulation of Facts	69a

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Statement.

This proceeding was instituted in the Tax Court of the United States by filing a petition on June 5, 1950 for a redetermination of the deficiency set forth by the respondent in his notice of deficiency dated March 8, 1950. Trial was had before the Honorable Eugene Black on November 16 and 17, 1953. Before deciding the case Judge Black retired from the Tax Court and the case was referred to the Honorable Morton P. Fisher who filed his opinion and findings on May 18, 1955 (24 T. C. 27).

On June 17, 1955 petitioner moved for a rehearing, further hearing and reconsideration by the whole Court. The motion was denied by an order of Judge Fisher filed December 1, 1955. The Court's decision determining deficiencies was entered March 26, 1956.

This proceeding was consolidated below with four others but has been severed on this appeal. Victor G. Mount has been substituted as petitioner's counsel.

[1331]

Decision.

THE TAX COURT OF THE UNITED STATES

WASHINGTON

[SAME TITLE.]

Pursuant to the determination of the Court, as set forth in its findings of fact and opinion filed May 18, 1955, the respondent filed a computation for entry of decision herein on December 20, 1955. Due notice having been given, respondent's computation was called for settlement under Rule 50 on March 21, 1956. Petitioner having filed no objection to respondent's computation and having failed to appear at the hearing on settlement, it is

ORDERED and DECIDED: That there are deficiencies in income tax in the amounts of $290.47, $11,576.53, $1,138.79 and $2,560.31 for the taxable years 1944, 1945, 1946 and 1947, respectively.

Enter:

MORTON P. FISHER

Judge

Entered: March 26, 1956.

[998]

Opinion and Findings.

* * * * * * *

1. Petitioners engaged in a number of promotional business ventures up to 1939. From 1939 through 1947, petitioners' main activities (other than the practice of law, in which three of them were engaged) were in the capacity of stockholders, officers, directors and employees, first of Aircraft and Arms Consultants, Inc., then Rumsey Manufacturing Co. (Balch-Morris), and finally Rumsey Products Co. Several of petitioners made loans to Rumsey Products in 1947 by giving the company their personal checks and concurrently receiving in return a check of the corporation in the same amount and similarly dated. Certain loans remained outstanding and became worthless in 1947 when Rumsey Products was adjudged bankrupt. *Held*, petitioners were not engaged in the business of organizing, promoting, managing, financing and making loans to such corporation, and are entitled only to deductions for nonbusiness bad debts in accordance with the provisions of Section 23(k) (4).

* * * * * * *

(4) In 1941, four of petitioners were assigned an interest in certain claims owned by John Balch. The interests of three of them were acquired by gift, and that of the fourth by "buying into a partnership." These claims were later assigned to Rumsey Manufacturing Co. to be used as collateral in conjunction with a bank loan, subject to an agreement that the claims, or the proceeds thereof, were to be returned to petitioners when no longer needed by Rumsey Mfg. In 1945 Rumsey Mfg. distributed the monies realized on these claims. *Held*, (a) that petitioners failed to establish any basis for their respective interests in said claims, and (b) that the proceeds realized

are not to be treated as capital gains since they were received in satisfaction of a claim and not as the result of a sale or exchange.

(5) In 1945, Rumsey Mfg. made a cash distribution in connection with the retirement of its preferred stock. The company had sufficient earnings from which to have declared a regular dividend and there was no valid business reason for retiring the preferred stock of the company. *Held,* that the distribution was not made in partial liquidation but was a distribution essentially equivalent to a taxable dividend.

* * * * * * *

(8) Petitioners incurred certain expenses in 1947 in the course of unsuccessful proceedings to reorganize Rumsey Products. *Held,* upon the facts, that the items are not to be treated as business losses or business bad debts.

* * * * * * *

(12) Petitioner Theodore C. Bonney made certain repairs, which were necessitated by storm damage, to premises rented from Rumsey Mfg. and occupied by Bonney as tenant. Bonney was under no legal obligation to make such repairs. *Held,* that the amount of damage to the premises was not allowable as a casualty loss to Bonney who failed to produce evidence of basis necessary to meet the requirements of Section 113(b).

(13) In 1937, petitioner Theodore C. Bonney married Edna Wheaton Stark, herein referred to as Edna. In 1945, petitioner learned that Edna had been previously divorced and forbidden to remarry. Petitioner sought and was granted a decree declaring the marriage a nullity. Petitioner claimed a deduction as a theft loss in 1945 for monies given to Edna for clothing and spending money from 1937 to 1945, during which period they lived together

as man and wife. *Held*, upon the facts, that petitioner is not entitled to a deduction for a theft loss.

(14) In conjunction with court proceedings to declare the ceremonial marriage of 1937 void *ab initio*, Edna filed affidavits containing allegations which impugned Bonney's personal character and professional integrity. She also publicized these matters within the community to the detriment of petitioner Bonney (who was a practicing attorney and corporate executive), and threatened to continue to do so. In order to stop Edna from carrying out her threats, petitioner paid her a substantial amount of money and caused to be conveyed to her his interest in a valuable farm. Petitioner claimed the amount of cash paid and the asserted value of his interest in the farm as a loss from theft or, in the alternative, as a business expense. *Held*, that while the payment and transfer were the result of extortion, the loss was not a theft loss within the meaning of section 23(e)(3). *Held, further*, that the payment and transfer of an interest in property to an extortioner was not an ordinary and necessary expense either in relation to the practice of law or to petitioner's functions as a corporate executive. Public policy considered.

ALBERT AVERBACH, Esq., for the petitioners.
THOMAS R. CHARSHEE, Esq., for the respondent.

FISHER, *Judge:* The respondent determined deficiencies in the Federal income taxes of petitioners as follows:

Years	1944	1945	1946	1947
Samuel Towers		$ 1,297.04	$1,098.10	$ 356.20
Albert Towers	$3,670.92	23,590.05	6,326.52	199.74
Theodore C. Bonney	6,608.63	16,129.99	5,607.44	3,036.44
Albert Averbach	1,136.27	13,707.03	1,104.83	1,652.87
David M. Hayman	696.98	15,328.05	431.39	

The issues presented for our consideration are:

(1) Whether certain unpaid loans made by several of petitioners in 1947 to Rumsey Products, Inc., with which they were variously associated as stockholders, employees, officers and directors were business bad debts arising from a business of promoting, organizing, managing and financing business enterprises, or were nonbusiness bad debts.

* * * * * * *

(4) Whether a distribution in 1945 by Rumsey Manufacturing Co., the stock of which was owned by several of petitioners, represented a distribution of profits or the repayment of the proceeds of certain claims, and if the latter, (a) whether petitioners have established a basis for said claims, and (b) whether or not the proceeds are to be treated as capital gains.

(5) Whether a cash distribution made by Rumsey Manufacturing Co. in 1945, in connection with the retirement of its preferred stock was made in partial liquidation or was a distribution essentially equivalent to a taxable dividend.

* * * * * * *

(8) Whether or not certain expenses, or any part thereof, incurred by several of petitioners in an unsuccessful attempt to reorganize Rumsey Products, Inc., in connection with proceedings in bankruptcy in 1947, are deductible as either business losses or business bad debts.

* * * * * * *

(12) To what extent, if any, petitioner Bonney suffered a casualty loss, within the meaning of section 23 (e) (3), as a result of amounts spent for repairs for storm damage to the premises rented by Bonney from Rumsey Mfg. when Bonney was under no obligation to make any such repairs.

(13) Whether, in the particular circumstances of this case, monies which petitioner Bonney gave to Edna for clothing and spending money during the period that they lived together as man and wife may be deducted as a loss from theft under section 23(e) (3), when their marriage was, in fact, a nullity and was allegedly induced by fraudulent misrepresentation.

(14) Whether certain monies and property which Bonney transferred to Edna to deter her from further spreading allegedly false and malicious statements concerning Bonney's personal character and professional and business integrity are deductible either as theft losses or business expenses.

Of the remaining issues raised in the petitions, some have been settled by stipulation of the parties. Others have not been urged in petitioners' briefs, and are deemed to have been abandoned.

General Findings of Fact.

The facts are partly stipulated and, to the extent so stipulated, are incorporated herein by reference.

All of the petitioners filed timely Federal income tax returns for the years involved with the then collector of internal revenue for the twenty-first district of New York.

Petitioners Albert Averbach, Theodore C. Bonney, and David M. Hayman are attorneys at law who have actively engaged in the practice of law for many years.

It is stipulated in respect to each of petitioners, *inter alia*, that,

> During the years 1936 to 1947, inclusive, petitioner was engaged in a number of promotional business ventures. He made loans, advances and gave other financial assistance to said ventures in

> varying amounts. He also spent [sic] a great deal of time and effort to [sic] the various enterprises * * *.

Petitioners' various promotional activities until 1939, as they appear from the record, were as follows.

Albert Averbach. In 1934, Averbach investigated the possibility of promoting a door-to-door sale of Eugenie Products cosmetics. In 1935, he organized the Music Users Protective Ass'n to combat abuses of ASCAP, and had an interest in the operation of a burlesque theater and a night club. In 1936, he investigated the possibility of acquiring a razor blade company[1], and of promoting Sam Chiodo's hair dye preparation; he also had an interest in the promotion of a single motion picture called "A Clouded Name," and in the operation of a night club. In 1937, he investigated the possibility of promoting or marketing numerous formulas, patents, devices, products and business ideas, such as sun tan oil, mosquito repellant, a self-expelling can, "blade-away," a liquid dentifrice, fire proof cloths and fabrics, the sale of perfume through vending machines, the Hunt Club line of men's toiletries, Ponaris Tooth Ache Poultice, Syroco Dog Banks, a new type electric razor, the Mary Scott Powland line of cosmetics, Tiny San, a display package case for ten cent items, a woman's magazine,[2] the establishment of a chain of milk bars, Chill-Chest icebox, sale of an automobile hinge, Consention Can Opener, sale of advertising space on electric clocks, acquisition of closed motion picture theaters, Kanfoush Insecticides, Mochatelle—a South American drink, a display case for the sale of low priced drug items, an educational film, patents of Miss Beulah Louise Henry (Lady Edison), con-

[1] Albert Towers also participated.

[2] Albert Towers also participated in the investigation for all of the aforementioned items and ideas in 1937. Theodore Bonney took part in the investigation of Tiny San.

struction of radio cabinets, and the organization of the textile industry on the employer level.[3] In 1938, Averbach investigated possible promotion of a telephone answering service, the merger of various cosmetic firms,[4] a national lottery, Neufud, and a car repair credit plan. He also acquired an option on the MacIntyre Iron Mines properties (not subsequently exercised) and organized the American Bar and Restaurant Association for the purpose of supporting legislation to prohibit department, drug, and 5 and 10 cent stores from selling food over the counter. In 1939, he investigated the possibility of promoting a merger of several laundry plants, an electric shave powder, and a cutting surfaces sharpener.[5]

Albert and Samuel Towers. In addition to those promotional investigations in which Albert participated with Averbach as indicated above, he, along with his brother and father, from 1927 to 1929, operated Bonn's Proprietary General Merchandise & Store (see *infra*, Issue 7) and invested in the construction of a number of single-family dwellings. In 1931, the three Towers invested in Pierre Cosmetics (see *infra*, Issue 7). Between 1930 and 1935, Albert and Samuel Towers invested in the distribution of razor blades.[6]

David Hayman. Hayman participated with Albert Averbach in almost all of the promotional investigations as indicated above. In addition, in 1931, Hayman was in the used car business, in 1935 he purchased a part interest in some real estate, in 1936 he participated in the operation of Chimes Discount Company which was engaged in purchasing mortgages on automobiles, and in 1935 and 1938, he invested in Hayman Auto Parts Corporation engaged in purchasing scrap metal.

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[3] Theodore Bonney participated in investigating the last 11 items and ideas.

[4] Albert Towers also participated.

[5] Albert Towers also participated.

Opinion and Findings

Some time in 1939, with war impending, Albert Towers, Albert Averbach, Theodore C. Bonney, David M. Hayman, and John Balch, now deceased (hereinafter sometimes referred to as the group of five, the first four of whom are petitioners in this proceeding), became interested in a promotional service whereby many of the country's idle machine facilities might be utilized in the production of war materials. To put their plan into effect they organized a partnership, in July, 1940, under the name of Aircraft & Arms Procurement Company (hereinafter called Aircraft), maintaining offices in the Chimes Building in Syracuse, N. Y., and in New York City. Engineers, office personnel, and others were hired. Individuals were sent around the country to locate machine shops which were not then actively engaged in full-time production and to interview the owners. Frequently, the Aircraft partners undertook this task themselves. If a shop was interested in engaging in war work and in participating in the Aircraft program, its full production facilities were analyzed, catalogued and indexed. This information, including the size and location of the plant, number of employees, and the different kinds of machine tool equipment owned, was published in a prospectus of shops available in various locations for war work. The prospectus was then offered to the large producers of war materials in both the United States and Canada, such as General Electric, General Motors, Curtiss-Wright, Chrysler Motors, Ford Motor Co., Douglas Aircraft, Boeing Aircraft, and others. The offer was made through an extensive mailing program, and large quantities of advertising in various trade magazines such as Aerosphere, American Machinist, different annuals of the aircraft industry, the New York Times and the N. Y. Herald Tribune, and the classified directory of the telephone company. Essentially, Aircraft, through its activity and publication, acted as a "clearing house" for

the prime contractors with Government orders to locate subcontractors with machine equipment available for production. At one point, Aircraft's canvass covered 105 different plants. In this way a number of contractors and subcontractors were brought together for the production of war materials, alleviating in some measure the production "bottleneck" caused by mobilization.

In addition to its listing service, Aircraft supplied many of the smaller shops with engineering advice. Aircraft broke down the operative steps of production for certain assembly items, categorizing the separate operations and component parts. On the basis of this service, Aircraft would suggest to large producers what kind of work could be handled by the various small shops with the equipment they had available.

Subsequently, Aircraft was incorporated as Aircraft & Arms Consultants, Inc. (hereinafter called Aircraft Co.). After incorporation, its consulting and information service was expanded to include 216 different plants.

In connection with the activities of first Aircraft, and then Aircraft Co., Albert Towers managed the New York City office and often traveled about the country to interview owners of manufacturing plants and to show the blueprint requirements of prime contractors. Expenses in this regard for maintaining the New York City office, traveling between the New York City office and the Syracuse office, the New York City office and Washington, and to various plants where it was necessary to go to interview prime and subcontractors, were advanced by Albert Towers. The other partners, later stockholders, also took an extensive and active part in the management and operation of the organization.

In 1941, as a result of their experience in 1940 and 1941, with Aircraft and Aircraft Co., the group of five became interested in undertaking prime contract work. At that time Morris Machine Works (hereinafter called

Morris), located in Baldwinsville, New York, had a large plant available for war work. Morris, however, did not have any previous manufacturing experience and did not have sufficient engineering knowledge to undertake such activity. Petitioners Averbach, Bonney, Albert Towers, Hayman, and John Balch (Balch being an industrial engineer who had previously managed various types of industrial manufacturing plants) organized a corporation with Morris under the name of Balch-Morris, Inc. (hereinafter called Balch-Morris), later renamed Rumsey Manufacturing Corporation (hereinafter called Rumsey Mfg.). The plant was equipped, and Balch-Morris obtained prime contract work on certain Naval gun mount components.

Later in 1941, the group of five, through their activities in Aircraft Co., learned that if the appropriate type of plant could be purchased, a Government contract for the manufacture of suspension units (undercarriages) for the Mark III Valentine, a British tank, could be obtained. The plant of Rumsey Pump Co., in Seneca Falls, New York, was located, and upon examining the equipment it was found adaptable to the special type of manufacture. The group of five purchased the plant by making a deposit of $25,000 which was borrowed on a note endorsed by each member of the group. The remainder of the purchase price, $180,000, and working capital was obtained by a loan from the Schroeder Trust Company of New York City (hereinafter called Schroeder), guaranteed personally by each of the group of five.

The contract was actually obtained and the Seneca Falls plant began to operate in January, 1942. At the same time, pursuant to certain negotiations (described *infra*, Issue 5) between Morris and the group of five, all operations of Rumsey Mfg. (Balch-Morris) were centered in Seneca Falls. Eventually that plant operated on three shifts, seven days a week, with a top number of 850 em-

ployees. At various times, from 1941 to 1945, Rumsey Mfg. became subcontractors and prime contractors on other jobs. At the peak of its operation, this plant had a fifteen million dollar volume of sales. During the course of its operation, Rumsey Mfg. availed itself of the facilities of Aircraft Co. and undertook such work as the manufacture of a TBY-2 landing gear as a subcontractor for Consolidated Vultee Aircraft Corp., fuse adapters for the United States Hoffman Manufacturing Corporation, truck parts and "sub-assemblies" for Chrysler Motors, and brackets, manifolds, and manifold covers for the Rolls Royce engine, used on American and British ships, for the Packard Motor Car Co., and for Continental Motors.

Briefly, during part of 1942 and 1943, Albert Towers, John Balch, Theodore C. Bonney, and Samuel Towers interested themselves in a venture organized as Seneca Farms Corporation (hereinafter called Seneca Farms) to raise hogs. In this connection the company was awarded a Government contract on the basis of competitive bidding to purchase the garbage disposal from the mess halls of the Sampson Naval Base. This operation did not progress any further and was not successful. Eventually it was abandoned because certain loans necessary to operate the farms were not approved by a Washington agency. The corporation, however, had other powers under its charter and the corporate structure was subsequently used to engage in the construction of six homes in the village of Waterloo. Only Albert and Samuel Towers participated in this aspect of the venture.

In 1945, the group of five became interested in a project known as Seneca Frozen Food Lockers. A partnership was organized to rent frozen food locker space to members of the local community. The project progressed to a point where petitioners contemplated buying land from Rumsey Mfg. on which to build the locker plant,

located a manufacturer of freezing equipment, advertised for customers, and rented the total capacity of locker space. The project was abandoned because the approval required for financing and operating it was not obtained from the Federal Government. Petitioners devoted only a small amount of time to this project.

During the years of World War II, the group of five devoted most of their time to the operation of the Seneca Falls plant. Bonney succeeded John Balch as President, Albert Towers because Vice President and General Manager, Hayman—Secretary-Treasurer, Averbach—Vice President and General Counsel, and Balch—Chairman of the Board of Directors and Chief Engineer.

Petitioners' income tax returns for the years in question disclose that Samuel Towers derived all of his income for the years 1945, 1946 and 1947, from services rendered as an employee of Rumsey Mfg. In 1944, 1945, and 1947, Averbach reported $2,300, $1,900 and $600 from Rumsey Mfg. and $22,701.95, $26,847.68, $17,500 and $18,438.49 in 1944, 1945, 1946 and 1947, respectively, from the practice of law. Albert Towers reported $25,566.22, $31,605.79 and $19,519.15 from Rumsey Mfg. in 1944, 1945 and 1946, and $2,084.95, $879 and $500 in the same years from the business of "Sales Counsel." In 1947, he reported $2,850 from Rumsey Mfg. only. In 1944, Bonney reported $24,938.91 from Rumsey Mfg., $783.17 from the operation of a farm, and a loss from his law practice. In 1945, he reported $29,594.26 from Rumsey Mfg. and again reported a loss from his law practice. In 1946, he reported $17,500 from Rumsey Mfg., $1,905.20 as a loss from his activities as "Lawyer and Executive," and $6,500 as a loss from his law practice. In 1947, he reported $2,850 from Rumsey Mfg., $150 from Climax Firebrick Co., and $9,374.02 from his law practice. In 1944, Hayman reported $20,939.73 from Rumsey Mfg. and $500 as an "attorney." In 1945 and 1946, he reported income

only from Rumsey Mfg. in the amounts of $26,692.28 and $16,153.90, respectively. In 1947, he reported $4,533.33 from Rumsey Mfg. and the practice of law, without segregation.

Except for the time which Averbach, Bonney and Hayman devoted to the practice of law, most of petitioners' activities were directed to the operation of Rumsey Mfg. from 1942 to July, 1947, and to the operation of Rumsey Products, Inc. (hereinafter called Rumsey Products), from November, 1946, to July, 1947, Averbach's main activity was the practice of law.

By October 1945, the Government had terminated its war contracts with Rumsey Mfg., tying up virtually all of its working capital of $850,000 to $1,000,000 in unpaid termination claims which were being questioned by the Government. After investigating several organizations and various products for the purpose of undertaking peacetime production, the group of five decided that it was "most prudent * * * to form a new corporation and to supply that new corporation with working capital." The group of five implemented their decision by organizing Rumsey Products in November, 1946, to manufacture electric lawn movers and automotive jacks (two-ton capacity garage jacks). Rumsey Products was to supply the materials and Rumsey Mfg. was to supply the labor at a contract price.

The capital structure of Rumsey Products consisted of 1,000 shares with a par value of $100 each, and 1,000 shares without par value. The total capitalization of Rumsey Products was $100,000, representing paid-in capital. Each of the group of five contributed one fifth, or $20,000, in cash. In return, each received 100 shares of preferred stock and 200 shares of common stock.

Early in 1947, it became clear that the operations of Rumsey Products, for various reasons not pertinent to the issues before us, were not then as successful as pe-

titioners had hoped they would be. It soon became necessary for petitioners to make various short-term loans to the company to meet pay roll commitments (described *infra,* Issue 1), and later to make advances to a "motor pool" organized to finance certain of Rumsey Products" purchases (described *infra,* Issue 2), By July, 1947, Rumsey Products and Rumsey Mfg. were adjudged bankrupt and petitioners suffered the various losses claimed in 1947. The plant and equipment of Rumsey Mfg. were subsequently sold at public auction and no attempt was ever made to reorganize that company.

After the bankruptcy and following the closing of the plant at Seneca Falls, petitioners attempted to reorganize Rumsey Products. A new plant in which to move equipment for undertaking production was required and, accordingly, petititoners investigated a number of plants and products and also demonstrated publicly the lawn mover which Rumsey Products had originally undertaken to manufacture. At the same time petitioners in some measure actively sought new business opportunities. In these connections petitioners variously investigated such possibilities as acquiring and marketing a Porterway Harvester, manufacturing an aluminum milk cap, manufacturing bowling pins, selling electric motors and bonded wire in Canada through a distributor, dealing in certain diamond tools used as cutting instruments in machine shops, exporting certain machine tools constructed with metric systems, and others. Petitioners also took options on certain plants during this time. However, each of these projects was rejected and petitioners permitted the options to lapse. No ventures were actually "launched" by petitioners in 1947. (Expenses incurred by petitioners are the subject of issue 8.)

Petitioners' promotional business ventures were not continuous and unbroken during the entire period 1936-1947, and did not constitute parts or incidents of a single

over-all business. Petitioners, in varying combinations and groups, actively sought a variety of investment and business opportunities at different times and from time to time. Many of their ventures never got beyond the point of preliminary discussion, though others did take shape as potential operating enterprises. Of these, however, a number were never finally carried into operation for various reasons, and others failed at a later time. Few succeeded, and with respect to a large number of these activities petitioners have reported no income in their returns. In many instances, petitioners did devote time and energy, and in a number of such instances, incurred expense in laying the groundwork for participation in an active enterprise.

Subsequent to 1947, several of the petitioners engaged in various business ventures. These, however, were not a part of a business pattern established prior to the taxable years in question, or continued through and after those years.

We find as an ultimate fact that petitioners' activities during the years in question did not constitute a single business or segregable groupings of businesses of promoting, organizing, managing and financing business ventures.

Detailed findings of facts relating to the respective issues under consideration are hereinafter set forth, numbered to correspond with the particular issue discussed.

Findings of Fact.

Issue 1.

On a number of occasions during the months of June and July in 1947 each of petitioners loaned monies to Rumsey Products in order that Rumsey Products might meet the then current payroll and other cash commit-

ments. The loans were short-term loans and were made by issuing a personal check to Rumsey Products and simultaneously receiving in return a check from the corporation, usually dated the same as the personal check given. The corporation's checks, however, were drawn on a different bank located some distance away. It was common practice for petitioners very shortly thereafter to deposit the corporate checks to their own accounts. In this way the corporation was able to obtain cash, which it otherwise did not have available, for short periods of time, frequently, only a matter of days. In each instance, except those for which a worthless bad debt has been claimed, the corporate checks issued were honored. It was not until a petition in bankruptcy was filed against Rumsey Products that any of the checks received by petitioners from the corporation were returned and payment protested.

The amounts lost on these loans by several of the petitioners were:

		Date of Rumsey Products' Obligations
Albert Averbach	$ 3,500	June 28 and 30
David M. Hayman	4,000	July 3 and 9
Samuel Towers	3,000	July 5
Albert Towers	22,000	June 21

Albert Towers' advances previous to June 21, 1947, which were unpaid on that date, were evidenced by four promissory notes, bearing six per cent interest, issued on June 21, 1947, each in the amount of $5,625, and due respectively on the 25th day of June, July, August and September of 1947. Other advances were without interest.

These various advances represented loans to the corporation, creating a debtor-creditor relationship between

petitioners and the company. The debts became worthless in 1947 when Rumsey Products was adjudicated bankrupt.

Opinion.

Issue 1.

Petitioner contend that the loans to Rumsey Products, which became worthless in 1947, were business bad debts arising from their business of promoting, organizing, managing and financing business enterprises, while the respondent has determined that the losses which were incurred in 1947 resulted from nonbusiness bad debts.

Section 23(k)(1) allows a bad debt to be deducted in full in the taxable year in which it becomes worthless, if it was incurred in a trade or business. Otherwise, it is treated as a short-term capital loss, and its deduction is subject to statutory limitations. "Business debt" is defined only by negative implication from subsection (4) of Section 23(k), providing that "the term nonbusiness debt means a debt other than a debt evidenced by a security," as defined elsewhere, and "other than a debt which is incurred in the taxpayer's trade or business." The accompanying regulations, Regs. 111, Section 29.23 (k)-6 (derived from H. R. No. 2332, 77th Cong. 2d Sess., page 76; 1942-2 C. B. 431), read as follows:

> A nonbusiness debt is a debt, other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business and other than a debt evidenced by a security as that term is defined in Section 23(k) (3). The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this question is substantially the

same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by Section 23(e) is "incurred in trade or business" under paragraph (1) of that section.

The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds are put by the recipient, but *is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer.* If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a nonbusiness debt for the purpose of this section. [Italics supplied.]

In each case the business or nonbusiness character of a debt and the requisite proximate relation of the debt to the business of the taxpayer is a question of fact. Cf. *Robert Cluett*, 3rd 8 T. C. 1178 (1947).

We think it is well settled that while the business of a corporation is not the business of its stockholders or officers, *Burnet v. Clark*, 287 U. S. 410 (1932), and that while a taxpayer may not cloak himself with the business of the corporation, even under circumstances where the corporation appears to be an "alter ego" of the taxpayer, cf. *Omaha National Bank v. Commissioner* (C. A. 8, 1950), 183 F. 2d 899, nevertheless, if a taxpayer makes advances to a corporation either as a stockholder or a corporate executive, any loss incurred as a result of these advances may qualify as a business bad debt if the taxpayer was in reality engaged in the business of promoting, organizing, managing, financing and making loans to business enterprises, *Weldon D. Smith*, 17 T. C. 135 (1951), reversed

(C. A. 2, 1953), 203 F. 2d 310, *Henry E. Sage*, 15 T. C. 299 (1950), *Vincent C. Campbell*, 11 T. C. 510 (1948), in the year in which the loss was incurred, *Hadwen C. Fuller*, 21 T. C. 407 (1953), and if the loss is proximately related to such promotional business. As we pointed out in *Charles G. Berwind*, 20 T. C. 808, 815 (1953), this rule is "applicable only to the exceptional situations where the taxpayer's activities in promoting, financing, managing, and making loans to a number of corporations * * * [may be] regarded as so extensive as to constitute a business separate and distinct from the business carried on by the corporations themselves." It is equally apparent that an individual may make a loan and suffer a loss therefrom under circumstances unrelated to his business even though his business be that of financing and making loans.

The record before us indicates that for a number of years up to 1939, when the group of five first organized Aircraft, petitioners had actively sought a variety of investment and business opportunities. Many of these activities never materialized after preliminary investigation and discussion. Some did develop to a greater degree but never went into operation. Others failed at still a later point. Few, if any, seem to have ever succeeded. Nevertheless, it is conceded that petitioners devoted time and energy and often incurred expense in laying the groundwork for participation in an active enterprise. It is also stipulated that each of the petitioners made loans, advances and gave other financial assistance in varying amounts to these ventures.

In 1940, the group of five organized and operated Aircraft and Aircraft Co., which, according to the testimony, were not ultimately very successful, presumably because the need for such a subcontracting "clearing" service diminished rapidly as war-time production got into full swing. As a result of their activities in Aircraft and Aircraft Co. the group of five were able to secure prime

contracts, work on which was begun in 1942, first through Balch-Morris and then Rumsey Mfg., the successor corporation.

In the record are stipulations of facts which include, *inter alia* the following in respect of each of the petitioners:

> During the years 1936 to 1947, inclusive, petitioner was engaged in a number of promotional business ventures. He made loans, advances and gave other financial assistance to said ventures in varying amounts. He also spent [sic] a great deal of time and effort to [sic] the various enterprises.

We, or course, give effect to such stipulations as far as they go. We point out, however, that no details are set forth therein, and there is no basis on which we may construe them to the effect that the parties to this proceeding agreed that the aggregate of the various promotional ventures, or any one or more of them in which petitioners engaged (frequently, but not always, together) over the period of years 1936 through 1947 constituted parts of a single business or of a grouping of businesses of promoting, organizing, managing and financing business ventures in each of those years. Moreover, the stipulations contain no statement or agreement that the activities of petitioners in relation to Rumsey Mfg. from 1942 to 1947, inclusive, or Rumsey Products in 1946 and 1947 constituted a business or were integral factors in any business carried on by them or any of them during those years.

It appears from the record that other than some time given by Bonney and Hayman to their law practices, most of the activities of petitioners Albert Towers, Bonney and Hayman from 1942 to 1946, inclusive, were as officers, directors and employees of Rumsey Mfg. The same may be said with respect to Samuel Towers, except that he was an employee and not an officer or director. During

this period, Averbach devoted most of his time to the practice of law, but was also active as an officer, director and employee of Rumsey Mfg. It also appears that for this period substantially all of petitioners' respective incomes were derived variously from the practice of law and from their services to Rumsey Mfg.

When it became necessary to convert to peacetime production, petitioners, on behalf of the company, actively sought products which they might manufacture, and ultimately, because of disputes over termination orders, organized Rumsey Products in November, 1946. Rumsey Products, however, was to operate through the facilities of Rumsey Mfg. and did not in reality represent a new enterprise. It was essentially a peacetime continuation of the operations previously carried on by Rumsey Mfg. Petitioners served the new corporation in the same manner as they had Rumsey Mfg., in addition to which Bonney, Averbach and Hayman continued to devote time to the practice of law. It was not until the fall of 1947, after Rumsey Products was adjudged bankrupt, that petitioners, as individuals, once again renewed their efforts in seeking various business opportunities, which in some measure they have continued to do to date.

We do not think that for the year 947 petitioners were, in fact, actively engaged in any business of promoting, organizing, managing and financing in so far as their services to Rumsey Mfg. and Rumsey Products are concerned within the intendment of the rule heretofore stated. *Hadwen C. Fuller, supra.* Nor do we think that the frequent loans to Rumsey Products in the months of June and July of the year in question represented either a business in and of itself, or a part of a business which consisted of promoting, organizing, managing and financing business enterprises. The loans appear to have been merely accommodation advances made from necessity, because of petitioners' practical interest in the company.

Opinion and Findings

We find nothing in the vague generalities set forth in the stipulations of fact, or any other circumstances in the record which support the view that the loans or advances in question were made as a part of the activities of any business consisting of the lending of money generally, or the promoting and organizing, managing, financing and making of loans to Rumsey Mfg. and later Rumsey products.

In the light of the foregoing we hold that the loans in question which became worthless in 1947, were nonbusiness bad debts. *Jan G. J. Boissevain*, 17 T. C. 325 (1951); *A. Kingsley Ferguson*, 16 T. C. 1248 (1951); *Estate of William P. Palmer, Jr.*, 17 T. C. 702 (1951).

* * * * * * *

Findings of Fact.

Issue 4.

In 1941, John Balch assigned a four-fifths interest in certain claims for commissions, due him from Morris, which passed equally to Albert Averbach, Albert Towers, Theodore C. Bonney, and David M. Hayman. This group subsequently reassigned the claims to John Balch who assigned them in turn to Balch-Morris, the predecessor corporation to Rumsey Mfg., to be used by Rumsey Mfg. (Balch-Morris) as collateral (in the approximate value of $33,000) in conjunction with the loan from Schroeder. The assigned claims were carried on the books of Rumsey Mfg. (Balch-Morris) as a "Donated Surplus Account" which was credited with $28,381.50. It was understood that the assigned claims, or the proceeds therefrom, would be reassigned, or distributed, to the assignors when no longer needed to obtain credit. Meanwhile, the assignors' right to demand repayment was subordinated to the rights of creditors and preferred stockholders of Rumsey Mfg. (Balch-Morris).

In 1943, Rumsey Mfg. received $28,381.50 on these claims by way of set-off of a claim of Morris against Rumsey Mfg.

On October 1, 1945, Rumsey Mfg. repaid this amount to the above named individuals in accordance with its prior agreement. A pertinent portion of the resolution adopted at a special meeting of the board of directors of Rumsey Mfg. on that date was as follows:

> whereas all of the debts of the corporation have now been paid or payment adequately provided for, and there now being no preferred stock of the corporation outstanding * * * and due demand having been made, it is
>
> RESOLVED, that the sum of $28,381.50, being the proceeds of said accounts receivable, be repaid to said John Balch, Theodore C. Bonney, Albert Averbach, David M. Hayman and Albert Towers, in equal amounts of $5,676.39 each. * * *

The preferred stock of Rumsey Mfg. had been called for redemption the same day. (See *infra*, issue 5.)

Each of the members of the original group of five received $5,676.30 from Rumsey Mfg., the total amount representing the proceeds of the John Balch claims for commissions. The group of five owned the stock of Rumsey Mfg.

Each of the petitioners who were involved in these transactions, other than Hayman, considered the original assignment as a gift from John Balch. Hayman received his interest therein by virtue of becoming a partner of the other four. The record does not establish Hayman's basis, as a partner, in the assets given or assigned by Balch, and does not establish any basis in the hands of Balch, as donor, with respect to the interests given or assigned to Averbach, Albert Towers and Bonney. The

petitioners affected, including Hayman, treated the amounts received in 1945, as the repayment of a loan which they had made previously to Rumsey Mfg. (Balch-Morris), then in the form of assigned claims from John Balch against Morris. These petitioners did not include as income, in their respective Federal income tax returns for any year, any part of the amount received in the year 1945. Respondent construed the transaction as a distribution by Rumsey Mfg. of profits, taxable to each of the petitioners involved as dividend income in the amount of $5,676.30.

The distribution by Rumsey Mfg. to petitioners was in fact the repayment of a loan or obligation and was not a dividend.

The assignment by John Balch of an interest or interests in his claims for commissions to Averbach, Albert Towers and Bonney, whether as individuals or as partners, constituted a gift.

Opinion.

Issue 4.

The issue as presented to us is whether the distribution of the "Donated Surplus Account" in the amount of $28,381.50 by Rumsey Mfg. in 1945 to petitioners Averbach, Albert Towers, Bonney, and Hayman represented the repayment of a loan previously made by petitioners to Rumsey Mfg. or was a dividend. Although, as will appear, *infra*, we do not think it makes any difference, upon the record before us, which way the items are treated, we think we should resolve the issue as presented, so that the parties may fully understand our approach.

Whether the transaction involving the assignment to Rumsey Mfg. of the "Balch claims" was the repayment of an obligation or a dividend is a question of fact. We

think that the stipulated facts, while not agreeing in every particular with some of the evidence adduced at the hearing, in all material respects point clearly to the assignment of the "Balch claims" to Rumsey Mfg. for an express and limited purpose. The assigned claims were to be used by Rumsey Mfg. to secure a loan from Schroeder and it was expressly understood by the petitioners and Rumsey Mfg. (Balch-Morris) that the assigned claims, or the proceeds therefrom, would be reassigned, or distributed, to the assignors when no longer needed to obtain credit. The value of the claims realized by Rumsey Mfg. in 1943 was in fact paid over to petitioners in 1945 at which time the board of directors of Rumsey Mfg. were of the opinion that Rumsey Mfg.'s other outstanding obligations had been satisfied and at which time the preferred stock of the corporation was no longer outstanding. Furthermore, it is pertinent to note that at all times the "Balch claims" were carried on the books of Rumsey Mfg. as a special account and were not commingled with any other surplus account.

We hold that the distribution was in repayment of an obligation from Rumsey Mfg. to said petitioners. We must, therefore, consider the nature of the transaction by which petitioners acquired their share of the assigned claims (whether by gift, or otherwise) and also determine the basis in their hands.

In a manner and for reasons which are far from clear on the record, John Balch, in 1941, assigned a four-fifths interest in certain claims for commissions due him from Morris. It is not altogether clear from the record as to whether the portions of the interest passing to Averbach, Albert Towers and Bonney, passed to them directly or as members of a partnership with Balch. In all events, a partnership was formed, which Hayman "bought into," and the parties regarded Averbach, Albert Towers, Bonney and Hayman each as owners of a one-fifth interest in the claims.

Petitioners urge that the assignment of the four-fifths interest was a gift from Balch.

While this view is a strain upon our credulity, it represents the uncontradicted testimony (except as to Hayman, with respect to whom the distinction is immaterial) and we accept it. We also call attention to the fact that respondent urges that there was no consideration for the transfer. We may add here that it is our view, as will appear, *infra*, that upon the record, it does not make any difference in the conclusion which we must reach.

Since we accept the view that the interests transferred by Balch to Averbach, Albert Towers, and Bonney were gifts, we must next turn to the question of basis. While the evidence may be sufficient for us to value the interests at the time the gifts were made, there is no testimony whatever as to any basis in the hands of Balch, the donor. The claims appear to have represented commissions due Balch for services, but there is nothing in the record to establish that he ever reported the claims or their value as income for tax purposes, or in any manner acquired a basis therefor. In the absence of evidence to the contrary, we must find a zero basis, since the three petitioners have failed to meet their burden of proof.

As to Hayman, if we hold that the transfer to him was a gift, the rule already announced would apply. If he acquired his interest as a partner (which appears to be the fact) he has likewise established no basis for his share of the asset, leaving his basis at zero with attending results as indicated with respect to Averbach, Albert Towers and Bonney.

Finally, we would hold that the amounts repaid to the four petitioners must be treated as ordinary income rather than as capital gains, because there was a mere return of the proceeds of the assigned claims, and not a sale or exchange within the meaning of Section 117(a)(2) or (4).

Opinion and Findings

Findings of Fact.

Issue 5.

In 1945, Rumsey Mfg. retired its preferred stock, each share having a par value of $100 and a call price of $130 per share plus accrued dividends. Petitioners Averbach, Hayman, Bonney, and Albert Towers each received $2,600 upon the surrender of 20 shares each. Petitioners reported no income from the retirement of their shares of preferred stock in 1945 or any other year.

The 20 shares of stock held by each of the petitioners were acquired by them in 1943 from Rumsey Mfg. Rumsey Mfg. had obtained them in that same year from Morris which had acquired them originally in 1941 for cash.

In 1942, the group of five organized Balch-Morris to operate the Morris plant at Baldwinsville for prime contract work on war materials. In this connection Morris conveyed a part of its plant to Balch-Morris. It was agreed that Balch-Morris would issue in partial consideration of these arrangements certain preferred stock to be callable at $130 per share plus accrued dividends, and that this stock should be called upon demand of the holder at such time as the financial condition of the company would properly warrant. Morris paid cash for 100 shares of the preferred stock of Balch-Morris and subscribed for 560 additional shares at $56,000. At a later date the original plan to operate the Morris plant at Baldwinsville was abandoned by the group of five and it was decided to purchase the Rumsey Pump Co. plant at Seneca Falls for war contract production. As a result of this decision, Morris and the group of five, on behalf of Balch-Morris, negotiated an agreement to rescind the original transaction by releasing Morris from its stock subscription for 560 shares of Balch-Morris

preferred and by reconveying to Morris its plant and building. In addition, it was agreed that the 100 shares of preferred stock paid for in cash by Morris would be returned to Balch-Morris if the name "Morris" were eliminated from the corporate name "Balch-Morris." In 1943, this stock was returned and the company name was changed from Balch-Morris, to Rumsey Mfg., "Rumsey" having been the traditional name of the plant in Seneca Falls for over 100 years.

The 100 shares of paid-up stock were turned over to the group of five in 1943 by Rumsey Mfg. (Balch-Morris), in accordance with an agreement made in 1941, partially as consideration for the assignment by said group of the "Balch claims" to Rumsey Mfg., to be used by Rumsey Mfg. as collateral for the loan from Schroeder (see *supra,* Issue 4 for description of this transaction), and also partially as consideration for the service rendered by them in arranging the rescission agreement. The minutes of a special meeting of the Board of Directors of Balch-Morris, dated December 21, 1941, in pertinent part are as follows:

> It was unanimously resolved that in consideration of the assignment of certain accounts receivable from Morris Machine Works to John Balch and subsequently assigned to this corporation all of the right, title and interest of this corporation in and to the certificate for 100 shares of Class A preferred stock now held by Morris Machine Works under an agreement expressed in a letter dated August 27, 1941 are hereby assigned to John Balch, Albert Averbach, David M. Hayman, Albert Towers, and Theodore C. Bonney as individuals, share and share alike. After due consideration and upon motion which was made and carried, it was resolved that the

560 shares of preferred stock of the corporation which were turned back to the corporation by Morris Machine Works on or about August 27, 1941 should be considered as having been cancelled as of August 27, 1941 and further resolved that such shares of preferred stock shall have the status of authorized but unissued stock which will mean that the corporation is now authorized to issue 1,000 shares of preferred stock and further resolved that the 101 shares of common stock which were turned back into the corporation on or about August 27, 1941 shall have been acquired by the corporation as Treasury stock and shall not have been cancelled with the result that the corporation now has authorized common stock in the amount of 200 shares, all of which is issued and outstanding. Upon motion duly made, seconded and carried it was unanimously resolved that in consideration for services performed by Theodore C. Bonney in connection with the cancellation of the stock subscription of Morris Machine Works and the legal services in connection with the transfer of realty heretofore deeded by the corporation back to Morris Machine Works and the preparation of certain contracts in connection therewith and for the further consideration of $1 the proper officers of this corporation are hereby directed and authorized to issue and deliver to the said Theodore C. Bonney one share of the common stock which shall be one share out of the 101 of common stock now held by the corporation in its treasury as treasury stock.

None of these petitioners reported the stock received as taxable income in 1943.

Opinion and Findings

On October 1, 1945, Rumsey Mfg. resolved to call in all of its preferred stock. The balance sheets of Rumsey Mfg. as of September 30, 1945, and October 31, 1945, are compared below:

Cash on hand	$ 701,832.37	$ 448,282.02
Inventories	38,466.74	42,812.24
Fixed assets	668,070.56	663,189.70
Total current assets	1,859,993.03	1,812,055.86
Total current liabilities	1,135,672.94	1,292,150.32
Capital surplus	599,645.82	527,264.32
Earned surplus	426,622.17	291,339.62

There was no diminution of the business of Rumsey Mfg. to which the retirement of the company's preferred stock and the capital represented thereby related, and there were sufficient earnings and profits available to have declared an ordinary dividend. The retirement of preferred stock caused no significant change in ownership in the corporation. We find as an ultimate fact that the distribution was one essentially equivalent to a taxable dividend.

Opinion.

Issue 5.

The question presented by Issue 5 is whether the cash distribution made by Rumsey Mfg. in 1945 in connection with the retirement of its preferred stock was made in partial liquidation or was essentially equivalent to a taxable dividend. Respondent made the latter determination. If the distribution was in partial liquidation, a subsidiary question is presented as to whether the petitioners have established any basis for their preferred stock.

Section 115, which concerns distributions by corporations, provides in subsection (c) that "amounts dis-

tributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock," thus according any gain realized the benefit of capital gains treatment. A partial liquidation is defined in subsection (i) as a "distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock." Superimposed on the treatment accorded circumstances which fit the pattern of a distribution made in partial liquidation is the provision of subsection (g) which requires that, "If a corporation cancels or redeems its stock * * * at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed * * * shall be treated as a taxable dividend," taxable in full as ordinary income.

Whether a distribution in connection with the retirement of preferred stock of a corporation is a distribution in partial liquidation or is a distribution essentially equivalent to a dividend depends on the particular facts and circumstances of each case. Therefore, the numerous cases cited by petitioners where distributions were held not to be taxable under section 115 (g) are not controlling, and we think that, in the circumstances of the instant case, they are of no particular aid in determining the problems before us. The respondent's determination is, of course, presumptively correct and it is incumbent upon the petitioner to show that the distribution was made in partial liquidation.

The principle to be applied in determining whether a distribution is essentially equivalent to a dividend under section 115 (g) is to determine the "net effect" of the distribution. Bad faith in making the distribution is not necessary to characterize it as one essentially equivalent to a dividend. *McQuire v. Commissioner* (C. A. 7,

1936), 84 F. 2d 431, affirming 32 B. T. A. 1075 (cert. den. 299 U. S. 591), but the taxpayers' motives and the plans and purposes of the corporation in making the distribution are relevant to determining whether or not the "net effect" of the distribution was essentially equivalent to a dividend. Cf. *Flanagan v. Helvering* (C. A., D. C., 1940), 116 F. 2d 937.

In the instant case, Rumsey Mfg. had a large (and perhaps unnecessary) accumulation of cash and sufficient available earnings in its earned surplus account from which an ordinary dividend distribution could have been made. Petitioners have not demonstrated that the distribution brought about any change in the ownership in the corporation or in the investment which petitioners had made in the corporation. Cf. *James F. Boyle*, 14 T. C. 1382 (1950) affd. (C. A. 3, 1951) 187 F. 2d 557, cert. den. 342 U. S. 817 (1951). We may add that Rumsey Mfg. had not previously paid any dividends.

Petitioners take the position that Rumsey Mfg. retired its preferred stock for business reasons, namely: (1) the capital represented thereby was no longer needed by the company in its operation; (2) the original purpose for issuing this stock in connection with the organization of Balch-Morris had been satisfied; and (3) it was to the advantage of the company to terminate the charge of dividends accruing to this stock. While it is clear that one factor which may be considered in determining whether or not a distribution is essentially equivalent to a dividend is the existence of a valid business purpose for making the distribution, *Joseph W. Imler*, 11 T. C. 836 (1948), it is equally clear that finding business purpose does not necessarily preclude the applicability of section 115 (g). Cf. *Estate of Charles D. Chandler*, *supra*.

We do not think that the record supports petitioners' contentions.

At the time of distribution, Rumsey Mfg. had not reduced its operating capacity and there was no clear intention to restrict its operating capacity immediately thereafter. The fixed assets of the corporation remained essentially uncha ed, and the corporation's inventories were in fact increased slightly. Plans for peacetime production to replace the work on war materials were being discussed. It was not until November 1946, more than a year later, that Rumsey Products was organized, with new capital, to undertake peacetime production through the facilities and working force of Rumsey Mfg. The circumstances of the instant case do not resemble those of *L. M. Lockhart*, 8 T. C. 436 (1947); *Joseph W. Imler, supra*, and *John L. Sullivan*, 17 T. C. 1420 (1952), affd. (C. A. 5, 1953) 210 F. 2d 607, relied on by petitioners, where in each instance there was a contraction of the corporate business with a corresponding reduction in the amount of capital used in the corporate enterprise. See *Estate of Charles D. Chandler, supra.*

Petitioners' contention that it was in accordance with sound business practice to redeem the stock, since the original purpose of issuing the stock had been satisfied, does not seem to us to accord with the facts.

The stock was apparently issued originally to protect Morris' investment in Balch-Morris by certain prior rights which accrued to the preferred stock. This purpose was already satisfied in 1943 when the group of five arranged to operate as Rumsey Mfg. at Seneca Falls and Morris was released from its stock subscription. All of the preferred stock held by Morris was returned to Rumsey Mfg. Retirement, therefore, could have been accomplished in 1943. Morris was no longer interested in the company and the stock which had actually been paid for, representing only a very small amount of the capital to be used in the operation of the company, was then in the control of Rumsey Mfg. Petitioners contend that the

preferred stock was distributed to them in 1943 as part of the consideration for an agreement entered into in 1941 for the assignment of the Balch claims, discussed under Issue 4. There is nothing in the record to indicate why additional consideration in this form was essential in view of the agreement to reimburse petitioners to the extent of the Balch claims when Rumsey Mfg. was in a position to do so. We can only assume, in the light of the control of the company by petitioners, that issuance of the preferred stock to petitioners was in the nature of a bonus or profit to them over and above agreed repayment of their interest in such claims, and it is at least conceivable that at the time the preferred stock was placed in petitioners' names, they had in mind its possible use to syphon off part of the profits of the business at a future date without the payment of the tax on ordinary dividends. The form of the transaction obviously lent itself conveniently to that objective.

Regarding petitioners' third contention that it was of advantage to the corporation to terminate future dividend charges that would accrue to the shares of preferred stock which were redeemed, we think that petitioners have not shown any such advantage to be substantial or material. The record does not disclose the total amount of such dividends. Moreover, it does not indicate that these accruals would have in any way impaired the continued or more successful operation of the company, or that their termination would have in any degree improved the credit position of the company.

We think that petitioners have not shown a significant corporate business purpose for redeeming Rumsey Mfg. preferred stock, and, to whatever extent business reasons did in fact motivate the corporation to make this distribution, we do not think that they are sufficient to counterbalance the other strong indicia of a distribution which was essentially equivalent to a taxable dividend.

Opinion and Findings

We hold on the basis of the foregoing that the distribution was essentially equivalent to a dividend. It is unnecessary, therefore, for us to consider the question of basis.

* * * * * * *

Findings of Fact.

Issue 8.

Following the filing of bankruptcy proceedings against Rumsey Products, and in the fall of 1947, petitioners made an effort to reorganize Rumsey Products. Petitioners Albert Towers, Bonney, Hayman, and Averbach each advanced funds to cover the cost of the reorganization proceedings. These advances were to cover court costs, travel expenses, attorneys' fees, and "other expenses of similar nature," in the following amounts: Albert Towers, $2,458.58; David Hayman, $2,708.58; Theodore C. Bonney, $2,610.63; Albert Averbach, $2,198.60. A reorganization was never effected and petitioners lost the monies advanced.

Opinion.

Issue 8.

In his statutory notices of deficiency, respondent disallowed the deductions as to Albert Towers, Hayman, and Averbach, but determined, as to Bonney, that the item be treated as a short-term capital loss. The question of whether the payments made by the other three should be treated the same as that of Bonney need not be considered by us, partly because the three petitioners did not assign error on that ground in their petitions (and de

not so claim in their briefs), and partly because, even if we should so determine, our holding would not change the resultant amount of the deficiencies in any of the years before us in view of statutory limitations upon the amount of allowable deductions for short-term capital losses.

All four petitioners maintain that the deductions should be allowed in full for 1947 on the theory that they are either business bad debts or business losses.

In considering the items from the standpoint of business bad debts, we find nothing in the record to support the view that they were debts at all. Rumsey Products was under the jurisdiction of a bankruptcy court, and there is no evidence to the effect that the court authorized the expenditures or took any steps to subject the bankrupt corporation to an obligation to repay. There is likewise no evidence of any express or implied promise on the part of the corporation to repay, assuming that it could have obligated itself while under the court's jurisdiction.

The items cannot be allowed as business losses because there is no evidence that the four petitioners were in any business to which the losses might be attributed.

In the light of the foregoing, we hold for respondent on this issue.

* * * * * * *

Findings of Fact.

Issue 12.

In 1947, Bonney spent $681.96 for repairing damage to the roof of a house which he occupied and which he had leased. The damage was caused by a storm during which some tree branches fell on the roof, puncturing it and causing it to leak. Neither Bonney nor the landlord was required under the lease to make any repairs.

Opinion and Findings

Opinion.

Issue 12.

It is clear that Bonney, as a tenant, had acquired an interest in the real estate, and was entitled to the possession of the leased premises which he occupied. *Coggins v. Gregorio* (C. A. 10), 97 F. 2d 948, 950; *Beall v. Everson* (Mun. Ct. of App. D. C.), 34 A. 2d 41; *Marden v. Radford* (Mo.), 84 S. W. 2d 947, 954; 229 Mo. App. 789; 51 C. J. S. Landlord and Tenant, par. 2b. (3), p. 511. As such, he had a property interest within the meaning of Section 23(e) (3) of the Code.

It is also clear that the property was damaged, and Bonney's interest therein, as tenant, was affected by the casualty. Our difficulty is in finding anything in the record from which we may determine an amount deductible as a loss under the appropriate provisions of the Internal Revenue Code. Assuming that Bonney suffered a casualty loss within the meaning of Section 23(e) (3), Section 23 (i) provides that the basis for determining the amount of the deduction shall be the adjusted basis provided in Section 113(b) for determining the loss from a sale. There is, however, nothing in the record from which we can either determine what that basis was, or whether the loss exceeded such basis. See *United States v. Kosh-Land* (C. A. 9), 208 F. 2d 636 (especially note 3, p. 639).

The proof of out of pocket expenditures for repairing the damage caused by the casualty presents an appealing argument for the allowance of a deduction to the extent of the actual amount of such expenditures. If permitted by the statute, it would here present a simple solution, although we can envisage difficult problems which would follow in its wake under more complex circumstances. We think it is clear, however, that the ex-

penditures for repairs, although resulting from the casualty, do not, of themselves represent or measure the storm loss of property for which provision is made by Section 23(e) (3).

We add that, since the damage was to a private dwelling not connected with a trade or business, we know of no other provision of the Code under which the actual expenditures might be allowable as deductions.

Findings of Fact.

Issue 13.

Petitioner Theodore C. Bonney first met Edna Wheaton Stark in the fall of 1936. Bonney was on his way to Oneida Lake, in upstate New York, to do some duck hunting, when he stopped at the Old Dutch Tavern, on the east side of the lake, for dinner. That evening, a party of several people, including Edna, her mother and father, and an uncle Eugene Hickock, a prominent lawyer, were also dining at the Tavern. Mr. Bergduff, the owner of the restaurant, and an old friend and client of Bonney, said that he would like Bonney to meet some people, and proceeded to introduce Edna and her party. Bonney was immediately attracted to her, and about eight months after their first meeting they became engaged. Bonney and Edna were subsequently married in Syracuse, New York, on August 19, 1937, by Bonney's father, a judge at that time. From that date, until April, 1945, Bonney and Edna lived together as man and wife.

Edna formerly had been married on June 6, 1921, and was subsequently divorced in the State of New York, in March, 1922. The decree of divorce had been granted on the grounds of adultery on her part, and she was prohibited from remarrying in the State of New York without a special decree from the Supreme Court of the

State of New York during the lifetime of her husband. On the date of the ceremonial marriage of Bonney and Edna, the decree of divorce was in force without modification, the husband was still alive, and no order had been issued by the Supreme Court of the State of New York to permit Edna to remarry.

At the time of his marriage to Edna, Bonney was not aware that she had been married previously, or that she had been divorced and prohibited from remarrying. For reasons not apparent on the record, Bonney became suspicious in April, 1945, and as a result caused an investigation to be made. After he ascertained the facts, some time in the early part of May, 1945, Bonney separated from Edna and commenced an action in the New York Supreme Court on October 25, 1945, for a declaratory judgment to declare his marriage a nullity. A trial was held at which Edna was present and represented by counsel, and Bonney was granted an interlocutory judgment on April 7, 1947, declaring that the ceremonial marriage of August 19, 1937, was void *ab initio*, in accordance with Section 6 of the Domestic Relations Law of New York, which provides that a marriage under circumstances such as those of the instant case is bigamous.

Bonney claimed a deduction in his 1945 Federal income tax return for $3,908.50 as monies obtained by Edna by fraud, deceit, false pretenses and theft. In that same year he also deducted the following amounts obtained from him in previous years in the same manner:

1937	$ 225.80
1938	1,187.69
1939	621.58
1940	1,402.17
1941	1,785.01
1942	3,333.34
1943	7,171.29
1944	4,268.70

All of these monies represent payments made to Edna for her clothing and spending money during the period that Bonney and she lived together as man and wife.

Opinion.

Issue 13.

The respondent disallowed the deductions in question on the ground that they do not qualify as proper deductions under either Sections 23(e) or (u) of the Code.

We think it is obvious that Section 23(u) of the Code, dealing with alimony payments in the case of a divorce or decree of separate maintenance, has no application, and that petitioner's only serious contention is that these payments were made under such circumstances as to constitute a loss by theft under New York law, giving rise to a deduction under Section 23(e) of the Internal Revenue Code.

Petitioner's theory is that these monies were obtained from him by fraud amounting to theft. Petitioner argues that Edna, knowing of her legal inability to marry petitioner in 1937, intentionally did not disclose this fact and thus by false pretense induced petitioner to go through a ceremonial marriage with herself for the purpose of obtaining monies from the petitioner. Petitioner contends that Edna's acts in obtaining such monies constituted larceny by false pretenses within the meaning of Section 1290 of the New York Penal Code, and that as a result, petitioner suffered a loss by theft within the meaning of Section 23(e) of the Code, deductible in full in the year in which the theft was discovered.

The question of whether or not the circumstances amount to theft depends upon the law of the State of New York. *Curtis H. Muncie*, 18 T. C. 849 (1952); *Morris Plan Co. of St. Joseph*, 42 B.T.A. 1190 (1940).

Section 1290 of the New York Penal Code defines larceny in the following language:

> A person who, with the intent to deprive or defraud another of the use and benefit of property or to appropriate the same to the use of the taker, or of any other person other than the true owner, wrongfully takes, obtains or withholds, by any means whatever, from the possession of the true owner or of any other person any money, personal property, thing in action, evidence of debt or contract, or article of value of any kind, steals such property and is guilty of larceny.
>
> Hereafter it shall be immaterial in, and no defense to, a prosecution for larceny that: 1. The accused obtained possession of, or title to, such property with the consent of the person from whom he obtained it, provided he induced such consent by a false or fraudulent representation, pretense, token or writing; or
>
> 2. The accused in the first instance obtained possession of, or title to, such property lawfully, provided he subsequently wrongfully withheld or appropriated such property to his own use or the use of any person not entitled to the use and benefit of such property; or
>
> 3. The person from whom the accused obtained such property intended to part with title to, as well as possession of, such property, or with possession as well as title; or
>
> 4. The purpose for which the owner was induced to part with possession of such property was immoral or unworthy.

We have no doubt that the word "theft," as used in Section 23(e) (3) of the Internal Revenue Code, includes larceny. We must decide, therefore, whether petititoner has established that he was in fact the victim of larceny by false pretense within the meaning of the New York statute.

In *People v. Lehrer*, 45 N. Y. Supp. 2d 170 (1943), the Court set forth the elements which must be established to constitute the crime of larceny by false pretenses within the meaning of New York law as follows:

> To constitute the crime of grand larceny by false pretenses, five elements must be established: (1) that there was a criminal intent to deprive and defraud the owner of her property (2) that the defendant made a false representation of a past or existing fact (3) that he knew that the representation was false (4) that he obtained the property and (5) that the person to whom the representation was made relied upon that representation and was in whole or in part influenced thereby to give * * * property to the defendant; in other words, that the representation in whole or in part was the inducing cause of the complainant parting with * * * money [p. 172].

Our review of the record does not convince us that petitioner has established these elements. While Edna no doubt looked to Bonney for support when she participated in the marriage ceremony, there is no evidence that she went through the form of marriage with the intent and purpose of obtaining from Bonney the monies in question which he turned over to her during the years 1937 to 1945, inclusive. The parties did in fact live together as man and wife during that period and, while Bonney did not know that the marriage was illegal, the money was willingly turned over to Edna without, so far as the

record goes, any importuning on her part. Even if the marriage had been legal and binding, she would have had no assurance that she would have received anything other than necessary support except by voluntary act on the part of Bonney. We do not doubt that if Bonney had known that Edna was not free to marry, he would not have gone through the form of marrying her, in which event the issue confronting us would not have presented itself. The concealment of the material condition against remarriage in her divorce decree, and her purported marriage to Bonney, were reprehensible acts on her part. We think, however, that there is a broad gap, which has not been bridged in the record, between those acts and the acceptance of the various amounts of money which Bonney gave her while they were living together. Upon consideration of all of the circumstances, we do not think that her acceptance of such monies constituted theft within the meaning of the New York statute.

Findings of Fact.

Issue 14.

In connection with the annulment proceeding referred to in Issue 13, Edna made application for temporary alimony and counsel fees, which is permitted under New York law when the defendant is a woman. In support of her application, she filed affidavits in the proceeding containing derogatory accusations against Bonney. These included assertions that Bonney had beaten her; that he knew at the time of their marriage ceremony about her prior marriage and of her divorce; that he (Bonney) had advised her as a lawyer that she was free to marry in New York State; that he ran a divorce mill; and that he had admitted to her that he had trumped up evidence in a divorce case. She also charged that Bonney had been

guilty of malpractice as a lawyer, that he was a liar and a perjurer, and that he had "double crossed" his clients and "sold them out." There was some notoriety in connection with these accusations and the charges were repeated in several newspapers published in Syracuse, Seneca Falls, and Norwich. In addition, Edna publicized these charges against Bonney by relating them to mutual friends and to various of Bonney's clients. Norwich and Seneca Falls being small communities, accusations made by Edna were widely circulated among the persons with whom Bonney had professional and business dealings.

Edna, in conjunction with her accusations, demanded that Bonney pay her a substantial sum of money and transfer certain property to her. She threatened to have disbarment proceedings instituted against Bonney if he did not satisfy her demands for such money and property.

As a result of these charges and the circulation of derogatory remarks and stories about Bonney, his professional reputation and personal character were seriously impugned, affecting adversely his standing in the community. A number of persons believed the charges, and, as a consequence, withdrew their business from Bonney. Others did not seek him out for professional services as they might otherwise have done. In 1949, the Martindale-Hubbell Legal Directory lowered its rating of Bonney in its Directory for 1949, in the light of the charges made against him concerning his law practice.

Some of those of Bonney's friends who did not believe the charges advised him that it would be well for him to do something about "quieting" Edna. At one point, Albert Towers, as General Manager of Rumsey Mfg., called Bonney to his office and advised Bonney that if matters were not straightened out between him and Edna, it

might be necessary for Bonney to resign from the presidency of Rumsey Mfg. Edna had made the statement to Albert Towers that she was going to come to Seneca Falls to inform Bonney's business associates and other persons with whom he did business for Rumsey that Bonney was a "crook" and was "unscrupulous." Towers told Bonney that the company was having enough difficulty without the addition of the unfavorable publicity surrounding Bonney's marital difficulty; that continued strife between Bonney and Edna was very bad for the company; and that perhaps someone else could be more helpful to the company as president than Bonney.

Bonney came to the conclusion that it was to his best interests in preserving his reputation as a lawyer and maintaining his standing with Rumsey Mfg. and Rumsey Products that he do something to get Edna to stop the campaign she was waging. To accomplish this, Bonney, on April 7, 1947, paid her $12,250 in cash and deeded to her his interest in a farm which had cost him $13,000 and which he had caused, during the period they had been living together as man and wife, to be placed in his name and hers as tenants by the entireties. He was afraid that if he did not do so, she would continue to do and say things harmful to him and to his reputation.

Opinion.

Issue 14.

Bonney claimed a deduction in the aggregate amount of $24,054 in his 1947 return, the above amount representing $12,250 paid to Edna in cash and $13,000 attributed to the transfer of his interest in the farm. Petitioner argues that these items constituted a theft loss on the theory that they were obtained under duress in circumstances which amounted to extortion; and second, in the alternative, that

the cash and property were paid and transferred to Edna in order to protect petitioner's professional and business reputation and standing, and thus properly constituted ordinary and necessary business expenses.

The New York Penal Code, Section 850, defines extortion as "the obtaining of property from another * * * with his consent, induced by a wrongful use of force or fear * * *." Section 851 provides further that:

> Fear, such as will constitute extortion, may be induced by an oral or written threat: 1. To do an unlawful injury to the person or property of the individual threatened, or to any relative of his or to any member of his family or to a corporation of which he shall be an officer, stockholder, employee or agent; or,
>
> 2. To accuse him, or any relative of his or any member of his family, of any crime; or,
>
> 3. To expose, or impute to him, or any of them, any deformity or disgrace; or,
>
> 4. To expose any secret affecting him or any of them; or,
>
> 5. To kidnap him or any relative of his or member of his family; or,
>
> 6. To injure his person or property or that of any relative of his or member of his family by the use of weapons or explosives. As amended L. 1911, cc. 121, 602; L. 1917, c. 518, eff. Sept. 1, 1917.

Section 857 provides as follows:

> Attempts to extort money or property by oral threats.
>
> A person who, under circumstances not amounting to robbery, or an attempt at robbery, with intent

> to extort or gain any money or other property, orally makes such a threat as would be criminal under any of the foregoing sections of this article or of section five hundred and fifty-one, if made or communicated in writing, is guilty of a misdemeanor. The provisions of this section do not apply to matters governed by section eight hundred and fifty-one of this act. As amended L. 1911, c. 121, eff. Sept. 1, 1911.

In the course of the proceedings in the instant case, Albert Towers, Bonney, and a friend of Bonney's (Mr. Mix) all testified that Edna threatened to continue to circulate her stories about Bonney, until he "would give her plenty." Bonney stated:

> She sent word to me that she wanted a large amount of money and a deed to the farm and that she was going to keep up this course of conduct until I gave up to her. * * *
>
> Some of them [friends of Bonney] conveyed messages to me that had been given by her to the effect that if I didn't pay she was going to institute disbarment proceedings against me. * * *

Assuming *arguendo* that the conduct of Edna resulting in the payment of a substantial sum of money and the transfer of property to her by Bonney amounted to extortion, we find nothing in the provisions of the New York Penal Code (Sections 850, 851 and 857) which would justify a construction to the effect that the crime of extortion, committed in the manner described in the evidence in this case, was tantamount to or included within the accepted meaning of the word "theft." It is obvious that the circumstances do not amount to robbery. Petitioner refers us to no authority which characterizes extortion, upon analogous facts, as theft under the New

York law, or defines the word "theft" as applicable to the facts before us. We hold that the procurement of the money and property by Edna did not amount to theft within the meaning of Section 23(e).

Petitioner contends in the alternative that the money and property he conveyed to Edna constituted an ordinary and necessary business expense. Petitioner argues that it was necessary for him to incur this expense in order to protect his law practice and his position as a corporate executive from irreparable damage, and that in the particular circumstances of this case it was quite ordinary to incur such an expense.

In considering this argument, we point out that we do not have before us the problem of the deductibility of expenditures paid in the defense of business reputation. We are here dealing with payments asserted to have been made to an extortioner demanding and accepting them without color of right. We know of no authority which warrants such an allowance, and we do not think it possible that Congress intended to permit a deduction as an ordinary and necessary expense of business under the circumstances confronting us. It is our view that such an allowance would be contrary to public policy.

Lindsay C. Howard, 16 T. C. 157 (1951), is clearly distinguishable from the instant case. Petitioner there incurred expenses for legal fees in defending himself in a court martial proceeding which might have led to dismissal from his position as an army officer. While the origin of the charge against Howard was a dispute with his ex-wife over alimony, the ultimate circumstances requiring the expenditure which was allowed arose out of his trade or business. Moreover, the payments were not made as hush money.

Likewise, *Catholic News Publishing Co.,* 10 T.C. 73 (1948), is distinguishable from the instant case. There,

petitioner's president had earlier served as the Treasurer of the Catholic Press Association. A controversy arose, based on a claim of the Association that petitioner's president had failed to properly invest certain Association funds, causing the Association to lose interest which would otherwise have accrued to it. Petitioner's president denied that he was guilty of any misconduct. The dispute, however, was having an adverse effect on petitioner's business. In order to protect its business, petitioner ordered its president to pay the sum claimed and subsequently reimbursed him for the amount paid. We allowed petitioner to deduct that amount as an ordinary and necessary business expense. Unlike the instant case, there was an actual controversy, and the settlement was of a disputed issue.

Huff, Andrews & Thomas, 1 B.T.A. 542 (1925), *Louisiana Jockey Club, Inc.*, 13 B.T.A. 752 (1928), and *Sands Springs Railway Co.*, 21 B.T.A. 1291, cited by petititoner, also involve situations significantly different from the one presented here. In each of those cases the expenditure which was allowed was made to avoid the likelihood of termination of the respective licenses under which the petitioners operated by an agency or organization which had the power to withdraw such license. It is clear upon examination of the opinions in the three cases that none of the elements of the instant case were involved.

For completeness, we add that there is no evidence in the case of the value, in 1947, of Bonny's remaining interest in the farm which he caused to be transferred to Edna in that year.

Reviewed by the Court.

Decisions will be entered under Rule 50.

Kern and Harron, JJ., dissent on Issue 5.

Arundell, J., dissents on Issues 4 and 5.

Order

MURDOCK, J., dissenting: I disagree with the result and reasoning on a number of issues including those mentioned below. The evidence seems sufficient to justify allowance of the bad debts as business bad debts. It is held that the 1945 distributions by Rumsey Mfg. of the "Donated Surplus Account" represented repayment of loans and, since that decided the only issue stated, it is error to go further and decide a point not raised in connection with those repayments. The retirement of the preferred stock of Rumsey Mfg. in 1945, was not shown to be within Section 115(g). I think "the remainder of the lump sum payment" in the "Barrand and Williams purchase" should be allocated. *Cohan v. Commissioner,* 39 F. 2d 540.

* * * * * * *

[1250]

Order.

The findings of fact and opinion in these proceedings were filed on May 18, 1955. On June 17, 1955, counsel for petitioners filed motions for rehearing, further hearing and for reconsideration by the whole Court with respect to Issues numbered 1, 2, 4, 9, 13 and 14, pursuant to Rule 19(e) of the Court's Rules, together with a brief in support of said motions. A hearing on said motions was had on July 28, 1955, at Washington, D. C. Upon consideration of the record, the oral argument by counsel, petitioners' brief in support of said motions, respondent's brief in opposition to granting said motions, filed August 29, 1955, and petitioners' reply brief in answer to respondent's brief in opposition, filed September 26, 1955, it is

ORDERED: That petitioners' motions hereinabove referred to be and they are hereby denied.

Dated: Washington, D. C., December 1, 1955.

MORTON P. FISHER
Judge

Transcript.

[15] ALBERT TOWERS, called as a witness by and in behalf of the plaintiff, having been first duly sworn, testified as follows:

Direct Examination by Mr. Averbach:

* * * * * * *

[50] Q. What was the purpose of that corporate set-up? [51] A. The purpose of that corporate set-up was to manufacture the electric lawnmovers. At that time we began to think about peacetime production. We had had terminations of our war contracts, and in those terminations we had all of the working capital of the corporation, which, as I recall it, was something between $850,000 and 1 million tied up in unpaid termination claims so that it became necessary in order to conduct our peacetime program for us to provide capital because the Government was questioning the termination claims and we decided that it was most prudent for us to form a new corporation and to supply that new corporation with new working capital in order to go on with our peacetime products, which were electric lawnmowers and automatic jacks, automotive jacks.

Q. Garage jacks? A. Garage jacks, two-ton capacity jacks, which we did. Under the new corporation which was supplied with $100,000 of capital by the five stockholders the Rumsey Products, Inc., was supplied with material purchased by the new corporation Rumsey Products and Rumsey Manufacturing supplied the labor at a contract rate.

* * * * * * *

[62] Q. Following the termination of the contracts in the year 1945, did you devote any time and energy to the acquisition or investigation of any other companies' products? A. As part of my duties as an officer and stockholder of Rumsey Manufacturing Corporation and also in line with my own work, my lifelong work, we investi-

gated the possibilities of any number of corporations either for acquisition by the corporation or for investment as individuals, as an individual, I should say.

Q. And in that connection did you and Mr. Bonney, Theodore Bonney, David Hayman, Mr. Albert Averbach, and the late John Balch take options on certain plants? A. Yes.

Q. Where? A. We took an option on a company known as the Otto Bernz Company in Rochester.

Q. What did that company make? A. They are manufacturers of blow torches.

Q. Were those options taken as individuals? A. I believe that one was taken as an individual.

Q. All right, what other companies? [63] A. In one case Mr. Bonney and I made a tender of an offer for purchase of a share in a company known as the Dekon Shipbuilding Company.

Q. Where was that located? A. That was in Long Island. We were offered individually a coal stripping operation in Pennsylvania which we investigated.

Q. Who was in that? A. In that one all five.

Q. As individuals? A. As individuals.

Q. What year was that? A. I believe to my recollection it was in 1946.

Q. What other companies? A. Well, there was the Hunter Arms Company in Oswego, which at that time was—

Q. Actually wasn't that Fulton? A. Fulton, which was a manufacturer of firearms, sporting guns. We investigated the possibility of acquiring it. I believe that one was for the benefit of the corporation, as I recall it.

Q. Go ahead. A. There were any number of companies, the Maydole Company in Norwich, New York.

Q. Do you recall the year of the Maydole Tool [64] Corporation? A. I believe that was in either 1945 or 1946.

Q. For the purpose of refreshing your recollection did that extend into 1947 after the bankruptcy? A. The Maydole Tool Company was offered to us on several occasions, I believe both before 1947 and subsequent to July, 1947.

Q. July, 1947, being the date of the bankruptcy of the Rumsey Manufacturing Company? A. That is correct.

Q. In that connection did you and Mr. Theodore C. Bonney, Mr. Albert Averbach meet with the officials of the Maydole Company in Syracuse? A. We met with the officials of the Maydole Company in Syracuse, and I believe we also met with the bankers and some of the creditors of the company in Norwich.

Q. Did you spend any time or money or energy in that connection? A. Yes.

Q. As an individual? A. Yes.

Q. How about Mr. Bonney? A. That is correct.

* * * * * * *

[65] Q. For the purpose of refreshing your recollection, did you as an individual, Mr. Hayman, Mr. T. C. Bonney, Mr. Albert Averbach, and John C. Balch take an option on a typewriter company known as the Barr Typewriter Company at Weedsport, New York? A. Yes, we did.

Q. Do you recall about when that was? A. I believe that was in 1941 or 1942.

Q. In that connection did you spend time or money or energy in investigating the potential of that particular machine shop? A. We spent considerable time in that.

Q. And money? A. Some money.

* * * * * * *

[70] Q. For the purpose of refreshing your recollection, in the year 1947, following the bankruptcy do you recall spending any time or energy or money in connec-

tion with the investigation of the marketing and acquisition of a Porterway Harvester? A. Yes, I do.

Q. All right. Now, who was in that investigation with you? A. All of the stockholders.

Q. Please name them again. A. Hayman, Averbach, Bonney, my brother Sam.

* * * * * * *

Q. For the purpose of refreshing your recollection, in the year 1947, following the bankruptcy, did you as an individual with Mr. Bonney, Mr. Hayman, your brother Samuel Towers and myself investigate the potential of a milk-capping device of a man by the name of Anderson? A. Yes, I recall that.

* * * * * * *

[71] Q. Do you recall, for the purpose of refreshing your recollection, devoting time, energy, and money investigating the question of potential of the Midstate Woodworking business in connection with the Redfield tract of timber and in connection with some bowling pin manufacturing?

* * * * * * *

The Witness: Yes, we investigated the possibilities of it, and rejected it, all five of us.

[72] Q. Before rejecting it did you devote time, energy and money? A. Yes.

Q. Did the others as individuals, the petitioners, do likewise? A. That is correct.

Q. Do you recall investigating and spending time and money and energy in connection with the investigation of a project of acquiring Bonded Wire and selling quarter horse motors in Canada through a man by the name of Moussett as a distributor and also in connection with that, an offshoot of it, a man by the name of McCarthy in the City of Syracuse? A. Yes, I recall that.

Q. Who was in that venture with you? A. All five.

* * * * * * *

Q. In the year 1947, for the purpose of refreshing your recollection, do you recall any contact with a Diamond Tool Project brought in by a man by the name of McNamara, the [73] Diamond tools being used in the machine shops as cutting instruments? A. Yes, I recall.

Q. Did you and the other petitioners involved in these proceedings devote time, energy and money in that connection? A. We attempted that.

Q. One more thing that I would like to call your attention to. Do you recall, and for the purpose of refreshing your recollection only, devoting time, money, and energy in connection with the sale of certain machine tools in connection with a machine tool dealer in Detroit by the name of Goldman and one down in New Jersey by the name of Segal, particularly tools that were constructed with metric systems for import originally to France and other countries? A. That was at the expiration of the war. During the war a good deal of machine tools were manufactured in this country with metric measurements for European operation. These type of tools were not usable in this country, and there was an oversupply of them, and we investigated the possibilities of purchasing these tools for resale to the European countries. We rejected that.

Q. However, in that connection to your own knowledge was considerable time, money and energy expended? A. Yes.

Q. Do you recall as an individual with these other [74] petitioners involved entering into an option on a plant at Poughkeepsie controlled by the Servel Refrigerating Company? A. Yes, but that was along about 1941, as far as I recall it.

Q. Well, do you recall that moneys were paid on an option and for extensions? A. I recall that.

Q. By individuals? A. By the individuals.

Q. Do you recall during the period of your activities with Rumsey Manufacturing and Aircraft and Arms Procurement spending considerable time, money, and energy in connection with the Dutch Purchasing Commission, Iraw and Iran Purchasing Commission in connection with the Oerlikon Gun contract and other missles? A. Yes, but that was in 1940 or 1941.

* * * * * * *

[77] Q. As to Rumsey Products, Inc., did you make certain attempts to reorganize that company? A. Along with Hayman, Averbach, Bonney, Balch, we attempted to reorganize the Rumsey Products, Inc. It was necessary to find suitable manufacturers to manufacture the items of Rumsey Products, Inc. before it could be determined by us whether or not it was worth while to organize the corporation. So we individually spent substantial amounts of money. I think in my case it was something like $2,400 in traveling expenses and hotel bills and in advertising for and interviewing proposed manufacturers of the two items that Rumsey Products, Inc. was making.

In that respect, we all travelled to various cities to inspect plant facilities, proposed plant facilities, for the manufacture of the items, in other words. We went to Youngstown, Ohio where we finally decided to have the jack manufactured. We went to New Jersey where we found a plant of Chicago Pneumatic Tool Company that in our opinion was suitable to manufacture the lawnmower.

These two were finally decided upon by us, and then we went ahead with our attempts to reorganize the company. But in the process we visited many plants which we inspected in order to pick one out.

Albert Averbach, for Plaintiff

Q. Now in that connection did you and Mr. Bonney, Mr. Averbach, Mr. Hayman, and Mr. Balch contribute to the cost of [78] a booth at the floral show at the garden show in the Grand Central Palace in New York? A. Yes.

Q. Where the lawnmower was exhibited? A. That was one of the expenses.

Q. Was there advertising in connection with that? A. Yes.

Q. Specifically do you recall whether it was a full page in the New York Times and in the New York Herald-Tribune? A. To the best of my recollection, it was.

Q. Did each of you contribute a proportion of that advertising expense and the expense of that show? A. We did.

Q. At that show did each of the five of you devote your energies in attendance and in exhibiting the lawnmower? A. Yes, we did.

* * * * * * *

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[146] ALBERT AVERBACH, was called as a witness, and having been first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Averbach:

* * * * * * *

[156] Now from that time on, in 1947 I continued promotional activities on my own part with in many instances Mr. Towers, Albert Towers, as an associate, Mr. Theodore C. Bonney, and in some instances with John Balch. They consisted since the bankruptcy in the following two categories: One, efforts to try to rehabilitate Rumsey Products in the reorganization.

Theodore C. Bonney, for Plaintiff, Direct

In that connection the three of us, Mr. Albert Towers, Mr. Bonney, and myself, made many trips to Cleveland, Ohio, Niles, Ohio, New York City and other places trying to find [157] some other prime contractor who would manufacture the electric lawnmower and also the hydraulic jack. Finally we were able to secure an agreement in writing with the Youngstown Steel Car and Foundry Company of Niles, Ohio, to manufacture one of our products, the hydraulic jack, and the Chicago Pneumatic Tool to manufacture the electric lawnmower at their Garfield, New Jersey plant.

We owned some equipment. We moved the equipment to Garfield and we continued trying to sell the electric lawnmower. In that connection we went down to the Garden Show in New York and Mr. Bonney, Mr. Towers, Mr. Hayman, Mr. Balch and myself and one of our employees, a man by the name of Drumm, for the entire show maintained a booth, sold the lawnmowers, demonstrated them, passed out literature, tried to do everything we could to further the sale of the lawnmower at the Garden Show.

* * * * * * *

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[173] THEODORE C. BONNEY, was called as a witness, and having been first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Averbach:

* * * * * * *

[179] Q. I show you Exhibit marked 20 for identification and ask you if this is an original assignment taken from the original records of the Rumsey Manufacturing Corporation showing the assignment of the claim for $33,000

previously assigned to Schroeder Trust Company by John Balch and reassigned to him taken from the books and records of the company as an original document? A. Yes, it is.

* * * * * * *

THEODORE C. BONNEY, the witness on the stand at the time of the recess, resumed and was examined and testified further as follows:

Direct Examination by Mr. Averbach:

* * * * * * *

[201] Q. If you had known that she was not free to marry you, would you have turned over a farm property to her or given the moneys that you did give to her?

* * * * * * *

The Witness: The answer is that I would not have turned over the moneys which are referred to in paragraph 10 of the stipulation nor would I have deeded her the farm as a tenant by the entirety in 1937, I believe it was, which I did do.

Q. By the way, from the time you deeded over the farm to Edna Wheaton as tenant by the entirety on or about October 11, 1937 up until the time you delivered a full deed to her, did you make the improvements and expend the moneys on the farm which are related in Paragraph No. 11 of the stipulation in your case totalling some $13,000? A. Yes, at least that amount. May I add to that that those expenditures on the farm, they were not mere casual repairs, or maintenance, they were a complete reconstruction of the buildings on the farm.

* * * * * * *

[202] Q. In the interim between the commencement of that action and April 7, 1947, what, if anything, did Edna Wheaton do?

* * * * * * *

The Witness:

* * * * * * *

[203] For quite a while I fought the thing, but I finally came to the conclusion that my reputation as a lawyer and as a business executive was being rapidly ruined, and my friends and clients, those that had some faith and confidence in me, told me about these things.

Some of them conveyed messages to me that had been given by her to the effect that if I didn't pay she was going to institute disbarment proceedings against me. I wouldn't have taken it so seriously but for the fact that she did obtain some false affidavits, affidavits that I knew to be false, and filed them.

I came to the conclusion shortly before April 7, 1947 that it was to my best interests if I wished to preserve [204] my reputation as a lawyer and that of my law firm in Norwich and if I wished to preserve my standing in respect to the business of the Rumsey Manufacturing Corporation and the Rumsey Products, Inc. and the relationship that that company had with banks and customers that I had better do something, if I could, to get her to stop the campaign that she was waging.

So on the 7th day of April, 1947, I did make her a payment of $12,250 in cash as is stipulated in Stipulation No. 11 and did deed over the remaining title to the farm that I referred to as stipulated in No. 11. I made that payment and that transfer in fear of what would happen to my reputation further and in order to prevent being falsely made a respondent in a disciplinary action by the Bar Association, although I wasn't guilty of any of the things that she charged me with, further to pro-

tect the interests of my father, who was my partner in our law business in Norwich.

* * * * * * *

[205] Q. Prior to this course of vindictive attitude and proceedings instituted by Edna Wheaton, how were you listed in the Martindale Law Directory? A. I was listed with the symbols which Martindale has used for years, the letter B, which indicated a high degree of skill in the practice of law according to their explanation in the front of the volume.

Q. And also high character? A. Well, the letter V following that is for high character, and G following that was for high credit rating.

* * * * * * *

[207] Q. Now is there any other phase of Edna Wheaton transactions which you have not testified to not covered by the stipulation? A. I would like to make it clear that I had no knowledge of her marriage to Stark and the invalidity of our ceremonial marriage until the month of April and May, 1945, and that every payment of money that I made to her or on behalf of her up to that time was made as a result of a fraud and deceit that had been practiced upon me and in reliance on the statements that she had made and the implied representations that she had made of being free to marry and being a woman of good character.

Q. Now as a result of the threats and attempts on the part of Edna Wheaton that you have related in detail, do you [208] claim that you were coerced in paying to said Edna Wheaton April 7, 1947 the sum of $12,250 mentioned in Paragraph No. 11 of the stipulation in cash? A. I do.

Q. And also the delivery to her of the deed giving her the full title to this farm? A. I do.

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[215] Q. For the purpose of refreshing your recollection, was it $5,676.30 which each of the five stockholders received as mentioned in Issue Two in this case in our brief? A. That is correct. Those five people were Albert Averbach, Mr. Hayman, Albert Towers, Theodore C. Bonney, and Balch. Now in connection with the original transaction of the loaning of this collateral security to the corporation to be assigned over to the Schroeder Trust Company back in December, 1941, there was a Directors' meeting held, and the minutes are in evidence here referring to the turning over of the right of the corporation to receive certain preferred stock back from Morris Machine Works.

That was done in consideration of the advancing and loaning of this account receivable by these individuals. That [216] stock had been originally issued for cash to the Morris Machine Works. Then when it was decided to abandon the project at Baldwinsville they used part of the plant of the Balch-Morris, and it was decided to buy this plant at Seneca Falls, and we had an understanding with Morris Machine Works that we would release them from their stock subscriptions of $56,000, I think it was, for preferred stock for which they had deeded over or were to deed over part of their plant.

We rescinded that transaction, gave back their plant and building, and our company took back 560 shares of preferred stock. At the same time, there was 100 shares of preferred which had been bought for cash by Morris Machine Works. It was agreed that Morris Machine Works would return that stock to the corporation, to our corporation, upon our corporation changing its name so as to eliminate the name "Morris" from Balch-Morris, and that is what was done in 1943.

We eliminated that name "Morris" and changed the name to Rumsey Manufacturing Corporation, which was

the traditional name at Seneca Falls, over 100 years of use of the name, and that was when we got back the 100 shares of preferred stock, and it was turned over to the five of us in compliance with the agreement made in December, 1941.

Then it wasn't immediately retired, but on October 1, 1945 the condition of the corporation was such, the war having ended, the big volume of war business being over with, we had [217] a substantial amount of cash on hand. The financial condition of the company was good. I think the balance sheets have been offered in evidence here and received. We felt that there was no need for the preferred stock remaining as a part of the capital structure of the corporation, so the stock was retired on October 1, 1945, and we received the money from the retirement of the stock.

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[226] *Cross Examination by Mr. Charshee:*

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[230] Q. Don't you think, Mr. Bonney, that if anybody accuses you of malpractice of the law that in order to protect your own reputation it would have been better to have aired it in a public tribunal and have them decide whether you were engaged in the malpractice of law? A. Well, I think that is a matter one has to exercise one's personal judgment about. My opinion at the time was that in view of my knowledge that she had the ability to procure false affidavits and false testimony, and I was sure that she was vicious enough to use every such weapon against me, [231] I felt at that time that I didn't want to take the risk and go through the added publicity of meeting these charges. Maybe that was a bad decision on my part, but I made the decision that way, and that is the way it was done; that is why I paid the money.

Q. The proper thing to do if you want to protect your reputation, you don't want to pay somebody off to keep them quiet, do you? A. Would you read that question?

(The question was read by the reporter.)

The Witness: I would say that if the somebody who was threatening your reputation was absolutely unscrupulous, vicious, and was going to use false witnesses and false testimony against you, and particularly when several of those were women, that it would be very difficult to effectively cross examine, and many of the instances no doubt would have been said to have occurred when I was there all by myself except for her witnesses.

I seriously would be afraid to go into a situation like that. I didn't feel confident that justice would triumph if I went through with the thing. I was afraid I might get defeated even though I were innocent. That is the way I felt about the thing.

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[233] Q. Getting down to this damage to your property, you rented that property, didn't you? A. Yes.

Q. There wasn't anything that that lease contained which required you to make any improvements? A. Nothing in the lease, Mr. Charshee.

Q. Just answer my question, please. There was nothing in the lease? A. Nothing in the lease that required me to fix it.

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Q. What were your activities in 1947 other than the [234] Rumsey Products? A. Other than Rumsey Products? Up to about July 17, 1947, from January 1 to July 17, inclusive, I was, oh, more than 90 per cent occupied with active participation and management of Rumsey Manufacturing Corporation and Rumsey Products,

Inc. We looked into several enterprises or schemes or promotions, businesses, that were submitted to us for investigation with the idea of getting us interested in taking them on or getting into them as promotions.

I think the Porterway Harvester, which was a very clever piece of machinery which could harvest quite a number of field crops that had never been successfully harvested by machinery up to that time—

Q. Maybe I can shorten this without your elaboration. How many business ventures were you engaged in in 1947 aside from Rumsey? A. Aside from Rumsey—which Rumsey?

Q. Rumsey Products. A. I was connected with Rumsey Manufacturing Corporation. Several of these others that I started to tell you about we investigated the possibilities of them. I wouldn't say I was connected with them, but I would say I spent some time, effort, and money to the extent that I travelled around and looked into some things.

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[235] Q. With respect to 1946 were there any other business ventures besides Rumsey? A. Yes, there was the Frozen Food Locker project and I spent a very considerable amount of time on that.

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Q. How about 1944? A. In 1944 and 1945 we looked into innumerable projects and possibilities. There was the Dekon Shipbuilding Corporation. Are you talking about '44 or '45?

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[236] Q. Is that all? A. There were numerous activities that I haven't discussed.

Q. There were numerous activities in 1944? A. In all of those years.

Q. In the nature of investigations or completed ventures? A. I wouldn't say completed ventures, but a large number of investigations. I was also operating a farm in 1944.

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[238] Q. Will you please tell us for the record how you happened to discover the facts in connection with the Irving Stark marriage and when? A. I looked at an old scrapbook which was in the house there, it was in a trunk. I was looking for something, and I saw this thing. I went through it, and I saw a picture, a newspaper picture, with a caption under it "Mr. and Mrs. Irving Stark," a picture obviously which had been taken a number of years before, but it was recognizable as Edna Wheaton. [239] As a result of that I became suspicious, and I caused some investigations to be made, and I found that there had been a marriage and a decree which up to that time had been completely unknown to me.

Q. As a matter of fact, did you cause a search to be made in various County Clerks' records to determine whether or not there had been divorce proceedings in the State of New York? A. I did. First I had a search made of newspaper files and found some newspaper articles about it and also found the paper where this picture had been clipped out.

Q. So in the answer of Edna Wheaton in the annulment action charging you with knowledge of these actions, was false? A. Yes, it was false.

Stipulation of Facts.

THE TAX COURT OF THE UNITED STATES.

[SAME TITLE.]

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2. Paragraphs 2, 3, 4, 17, 22, 24, 25, 26, 27, 28, 29, 30, 31, 32 and 40 of the stipulation of facts in the associated case of Albert Averbach, Docket No. 28779, are incorporated herein by reference.

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ALBERT AVERBACH,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Stipulation of Facts.

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27. Respondent construed the transaction as a distribution of Rumsey Manufacturing Corporation's profits taxable to petitioner as dividend income in amount of $5,676.30, or as a distribution of profits. On October 1, 1945, Rumsey Manufacturing Corporation repaid the loan made to it in 1941 by an instrument dated December 30, 1941, in which John Balch's claim for services as an industrial consultant to Morris Machine Works, was assigned to Balch-Morris, Inc., as collateral security in favor of the Schroder Trust Company. The income realized by the settlement of the claims of Balch-Morris, Inc., against Morris Machine Works occurred in the year 1943 when the corporation, acting as agent for John Balch, collected the claim from Morris Machine Works.

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